

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
SINGLE FAMILY APPRAISAL INDUSTRY ROUNDTABLE
SUMMARY OF REMARKS

JULY 14, 1998

INTRODUCTION

A roundtable discussion was held with approximately forty participants involved in the appraisal, real estate, lending and urban development industries. The discussion was focused on HUD's proposed changes to the Uniform Residential Appraisal Report (URAR) and the Valuation Conditions (VC) forms. The reforms are the result of a perception or reality that buyers obtaining FHA insured mortgages are entering transactions uninformed or under-informed about the physical condition and deficiencies in the houses they purchase. This missing information eventually results in default on debt and foreclosure on the property.

SECRETARY CUOMO'S INTRODUCTION

The Problem: FHA needs to work better. Because FHA plays an important role in the home ownership process, there is a mandate to make FHA work as well as possible.

The Secretary summarized the overall problem leading to today's discussion as the result of several factors. These factors exist in the overall residential marketplace, but are more prominent with FHA insured mortgages because of the segment of the population that HUD/FHA serves.

- FHA clientele is the least informed and least interested
- FHA buyers are less aware, therefore more vulnerable
- FHA buyers confuse insurance of financing with government "guarantee" of the housing condition

The home-buying system hinges on the idea of "caveat emptor" (buyer beware). If the consumer is not informed, they are at a serious disadvantage in the market. The population served by FHA is more likely to be uninformed and is therefore at a greater disadvantage. This section of the population is the least informed group of homebuyers. Once the government is involved, there is a perception that certain assurances are in place, when in fact, these assurances are not. This results in homebuyers entering the transaction without the benefit of understanding the transaction.

Current Situation: HUD just completed a total redesign of the appraisal process on the multi-family housing side of HUD. This included the appraisal process, physical inspections and the financing system. Protocols and automation were developed. However, HUD is also downsizing and therefore lacks resources to revamp the single family appraisal system on its own. HUD is downsizing from 81 offices across the country to four centralized processing centers. At the same time, Congress is moving toward mandating inspections for all FHA homes. HUD believes mandates would be

overkill and prefers to improve the process to bring confidence and surety to homebuying.

Goal: To improve the single-family appraisal process by learning from the private sector and other government and quasi-government agencies. HUD is attempting to bring a sense of clarity to the process. The goal is clarity and not an entire change.

"If we can make breakthroughs on this appraisal process, the better it will be for FHA and for industry."

-Secretary Cuomo, July 8, 1998

INTRODUCTORY REMARKS- IRA PEPPERCORN

The remarks focused on the same themes as the Secretary's introduction and brought forth some details about HUD's actions and goals. Specifically, HUD wants to create a mechanism to identify housing units in need of inspection. The test is not if the components are perfect, but rather if the basic components work or do not work. This is the question to answer when completing the VC form.

It is important to understand that HUD wants to key in on the entire process of single family housing reform. The appraisal piece is just one of the key aspects in the overall reform. The lender and borrower also need to be made more aware and educated about their roles in the process and more knowledgeable about how they can work together and with HUD to bring about this clarity.

Recognition was made that appraisers are not inspectors. The appraiser is only required to see if the components work and answer "yes" or "no". The appraiser would not speak directly to the borrower, but would be required to notify the lender of the observations. The lender would then notify the borrower. The process itself is intended to stay the same—the appraiser notifies the lender, and then the lender notifies the borrower.

HUD does not want to change the information that is currently requested on the forms; instead, HUD wants to clarify the way things are asked in order to obtain more information and to offer greater protection to the homebuyer. In an effort to enable this increased protection, HUD is now allowing \$300 of the home inspection fee to be financed within the mortgage.

INTRODUCTORY REMARKS - D. J. LAVOY

A brief discussion of formation and the responsibilities of the Real Estate Assessment Center (REAC) were provided. The focus of REAC is to measure the multi-family and public housing environment. Key terms for the REAC are Assess and Measure. The REAC will operate based on an ability to acquire the data objectively and have an easy means of extracting data. A large part of this ease of acquiring and abstracting data is founded in electronic transmission of the data to HUD.

The discussion proceeded to the changes in the VC form. Originally, the VC form had eleven components for the appraiser to complete. The revised form still has eleven

components, but HUD has moved the condition of the property to the beginning of the form and other components that may or may not be applicable are in Section 2 of the form. The next step in changing the VC and URAR forms is to mechanically link them as a single form that can be scanned and electronically formatted.

INDUSTRY PARTICIPATION AND ISSUES DISCUSSED

The platform was then opened to the industry participants for open discussion.

Valuation Conditions Form

The conversations about the changes to the VC form included the following major points, each of which will be summarized individually:

1. Increased accountability and liability of appraisers
2. Competence of appraisers
3. Educating the market and users of appraisal services
4. Terminology on the forms
5. Cost effectiveness of changes and appraisal fees
6. Participant recommendations

1. Increased Accountability/ Liability

Participants expressed concern about the level of accountability and resulting increases in liability that the appraiser will assume under the proposed new VC Form. Overall, the tone was set that the appraisers could perform the service, but in doing so would become even more vulnerable and less protected in providing professional services. Comments included the following:

- The various appraisal organizations concurred that their members would generally be willing to look at the structure of the new form. Additional controls and quality points will allow the appraiser to show his/her knowledge and increase his/her worth in the marketplace.
- One participant did not think the new VC form would increase liability. Any competent appraiser can perform an inspection or inspection-like tasks, therefore the same risk and liability would be intact as before the changes.
- The point of opposition to this form and the revision plans was based on the perception that the forms would require the appraisers to act as home inspectors, thereby increasing their liability and resulting in lost business or lawsuits for action or inaction in reporting the conditions of the property.
- HUD expressed the opinion that the home inspection is only as good as the person performing the inspection. The form is only meant to be a red flag, not a radical change. The revisions only provide clarity to the process.
- HUD posed the question about how liability is different at this point. The only answer provided was increased screening of the integrity of the appraisers and the need to increase professionalism.

2. Competence of Appraiser

Issues were raised regarding whether appraisers are competent to perform the proposed changes in the appraisal process. Education was a key topic discussed within this issue.

The point is that the appraisers will need to be educated about the proposed new VC form. HUD expressed the desire to tap into the existing educational infrastructure in the industry and professional associations.

Some participants thought the new form would require appraisers to act as inspectors and thus would make it necessary for the appraisers to be trained and educated to perform certain 'inspector-like' functions. Comments raised included the following:

- An explicit statement needs to be included on the VC form stating that the VC form is not an inspection.
- The difference between an appraisal and an inspection needs to be distinguished by home ownership groups and mortgage councils

2. *Educating the Market and Users of Appraisal Services*

One constant theme throughout the discussions was the need to educate the public and the real estate industry about the differentiation between an appraisal and an inspection. Targets for expanded education include the real estate brokers, lenders, homebuyers, community groups and other professionals involved in the home buying process. The rationale is that buyers who are typically under-informed to start with are easily misled by professionals that do not clearly and explicitly explain the process. Comments raised included the following:

- Lenders have a role to disseminate correct and complete information.
- The buyer does not currently receive certain appraisal information. Under the proposed changes the buyer will receive additional information. However, the use of the information by the buyer is suspect since the buyer is generally not sophisticated enough to understand the implications and the use of the information.
- There is a misconception in the market about the home warranty programs, which is not a substitute for a home inspection and should not be viewed as such. Also, the misconception that FHA and/or Federal government warrantees the home must be dispelled.
- For appraisal professionals, the FHA appraisal process has always had a physical review component that tested the safety and soundness of the house. This needs to be reiterated to the profession when explaining the reforms and the impact on the appraisers.

2. *Terminology Discussion*

Discussion occurred about the use of selected terminology in the proposed new VC Form. The liability issue arose again, as some participants argued that terms like "yes" and "no" were too definitive for some of the questions on the form. The appraisers were not necessarily skilled enough to answer in these terms. Alternatively, other participants argued that terms like "acceptable or unacceptable" were too subjective and increased liability for the appraiser. Also, the question of appraisers' competency to make that determination surfaced again. Comments raised included the following:

- The terminology used is too vague for certain response choices, specifically section VC-5 regarding "Mechanical Systems" (subjective "acceptable").

- There is often a gray area between whether something is “Working” and “Not Working”, when referring to certain topics like an air-conditioning system. Participants who held this opinion felt that the tougher questions should be worded to reduce the liability of the appraiser. The group felt that the “Yes” “No” response categories should be re-examined.
- A matrix to cross-index different components’ condition and acceptability will be incorporated into the guidebook. This matrix will provide a more solid method of recommending or foregoing the recommendation for an inspection. If certain conditions at the property are noted, the appraiser should recommend an inspection. This matrix would eliminate some of the subjectivity in the appraiser’s recommendations.
- Representatives from HUD committed to issuing a manual/guidebook, which will clarify some terminology and response categories. This manual will be used in conjunction with the proposed new VC form to facilitate the appraiser’s navigation through completing the form.

2. *Cost-Effectiveness*

The concern by HUD and the lending community is increased cost to the homebuyer in the buying process. Certain members of the appraisal community indicated that if HUD required a greater reporting or effort level that the fees for appraisals would increase. The appraisers also indicated that if the appraiser were placed in a position with liability and no protection, then the appraiser would recommend a home inspection without hesitation. HUD’s response was that the reforms were not intended to raise the cost of services and that the appraisers should have been performing these services before the reforms. Comments raised included the following:

- FHA will now permit up to \$300 for a home inspection to be financed in the mortgage. Previously, only \$200 could be financed. This will allow the home inspection to be accessible and obtainable to more buyers.
- HUD provided clarification about the difference in a buyer obtaining an inspection versus a home warranty and the benefits to the buyer for obtaining the home inspection. The participant’s comment was “*wouldn't it just be cheaper to use \$300 and purchase a warranty.*” It was noted that warranties do not include pre-existing conditions, thereby necessitating better inspections. Also the warranties do not provide the condition of the property, just some protection if the condition results in certain circumstances for the homeowner.

2. *Participant Recommendations*

Throughout the discussion about the proposed revised forms, the participants provided several suggestions for consideration by HUD. These suggestions are summarized as follows:

- FHA works with two types of properties, both old and new. Some questions and responses that might be applicable for some houses may not be for others. For instance, certain considerations need to be taken into account when dealing with an older home, such as the condition of the roof.
- Mandatory inspections for older homes in lower income neighborhoods.
- Explicitly state that “This Is Not An Inspection” on the VC form.

- The appraisal process needs to be looked at along with the other functions. For example, the pressure from lenders may cause appraisers to act in ways unintended by the proposed changes. The entire process requires reform, not just the appraisal process. (note: HUD is addressing this concern already)
- There was some agreement that the new VC and URAR forms are just part of the process of reform that HUD and FHA are trying to bring about.
- Additional reporting to the homebuyer by the lenders and the real estate industry was recommended.
- Multi-color flyers and direct brochures to the potential homebuyers could be developed that would clearly explain the role of HUD/FHA. This would eliminate the perception of a government-sanctioned house or the warranties that are assumed by certain buyers under FHA insured mortgages.
- Participants were anxious to continue the discussion and requested a timeframe for follow-up and continued interaction.
- Participants also requested a timeframe for production of the guidebook and the additional information in filling out the VC and URAR forms. This additional information includes the second round of revisions to the forms as a result of this roundtable.

Uniform Residential Appraisal Report Form

Most of the participants agreed that the new changes to the URAR form would result in a more thorough appraisal and a greater examination of the condition and the features of the house. However, many questioned whether this was a good or bad thing because these improvements might be accompanied by additional time added to the closing process and perhaps even adding extra costs.

Although some participants questioned whether consumers would be content to use FHA financing as a result, Ira Peppercorn said, *"The consumer might say, 'FHA will have a more thorough check' even if it is a slower process."*

Suggestions by participants

In the discussion, the industry participants provided the following recommendations.

- It was agreed that the homebuyer section needs to be simplified and shortened. It should also say that homebuyers can request an inspection and a warranty if they desire.
- Participants indicated that a protection might be inclusion of a box on the form asserting that the buyer has received a copy of the appraisal. (Most Lenders do this already)
- Additional education of the buyer in the process needs to be achieved.
- Delete the adjustment lines for items 110 and 111- the Age and Condition of the property. The inclusion of specific new categories makes these general categories redundant and unnecessary.
- There was much discussion on the entry of Data Verification and/or sources for verifying a sale. The discussion focused on how an appraiser would obtain the necessary information for the comparable properties. Disagreement ensued regarding the current USPAP requirements and the soundness of the adjustment process.

- There was some agreement that the new VC and URAR forms are just one part of the process of reform that HUD and FHA are initiating.

ROUNDTABLE OUTCOMES

The following actions and considerations will be undertaken and completed by HUD as a result of the feedback from the industry roundtable.

1. Issues to Review

- Differentiation when appraising urban and inner city properties
- Age of dwelling affecting the mandate for inspections or the protocol
- Increased liability for appraisers
- Protecting consumers in the home buying process
- Obtaining correct information versus the complexity and delays in the sale of a home
- Training and education of buyers and real estate and lending professionals

1. Additional Comments by Participants

- FHA appraisers should have a training session about changes in the forms and the processes.
- The marketplace may not be ready for a better appraisal system.
- People will need to buy into this process. If buy-in is achieved from all stakeholders then a better product will be produced for all parties involved.
- HUD and FHA are working on other elements of the process. (not just the appraisal part)

1. Action Items

HUD committed the following action items as a result of the conversations at the roundtable.

- Follow-up with selected participants to discuss their specific issues.
- Another meeting was mentioned for later this summer: Topics to discuss will include appraisal standards and homebuyer education.
- Minutes will be mailed to participants, including a list of participants.
- A guidebook/manual for the appraisers will be produced and comments will be solicited from the industry groups affected.
- Participants should respond with the names of others that might be able to add information to the preceding topics. Please complete and return the attached form.